88-186

No. .....

Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1988

—o—

THOMAS TEW, as Trustee for ESM Government Securities, Inc., and as Receiver for ESM Group, Inc. and ESM Financial Group, Inc.,

Petitioner,

v.

ARKY, FREED, STEARNS, WATSON, GREER, WEAVER & HARRIS, P.A., & EUGENE E. STEARNS,

Respondents.

—o—

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

—o—

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QUESTIONS PRESENTED

1. Is an attorney who has knowledge of a client's on-going fraud obliged to ensure that the fraud is stopped, or at least to take precautions not to assist the client in continuing the fraud?

2. When requested by a client to respond to an auditor's request for information, is an attorney obligated to respond truthfully, or if a truthful response would reveal a client confidence, not to respond at all?

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ARKY, FREED, STEARNS, WATSON, GREER, WEAVER & HARRIS, P.A., & EUGENE E. STEARNS,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

Thomas Tew, as Trustee for the bankruptcy estate of ESM Government Securities, Inc., and as equity receiver for ESM Group, Inc. and ESM Financial Group, Inc., respectfully petitions for a writ of certiorari to review the judgment in this case of the United States Court of Appeals for the Eleventh Circuit.

OPINION BELOW

The court of appeals' *per curiam* affirmance of the district court's Judgment Orders is attached as Appendix "G". The Judgment Orders of the United States District Court for the Southern District of Florida (Gonzalez, D.J.) (App. "C" and "D") are reported at 655 F.Supp. 1571 (S.D. Fla. 1987) and 655 F.Supp. 1573 (S.D. Fla. 1987).

JURISDICTION

The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1). Certiorari is necessary to consider issues of great public importance and to correct a conflict in principle between the court of appeals' affirmance of the district court's decision in this case and *Nix v. Whiteside*, 475 U.S. 157 (1986).

STATEMENT OF THE CASE

A. Course of Proceedings and Disposition in the Courts Below

From 1977 until 1985, the officers and directors of the ESM Companies[1] engaged in the most massive securities fraud in United States history up to that time. The ESM

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[1] Unless otherwise indicated, the terms "ESM" and "the ESM Companies" refer to ESM Government Securities, Inc., ESM Group, Inc., and ESM Financial Group, Inc.

Companies, located in Ft. Lauderdale, Florida, were securities brokers which primarily sold government securities to customers. In the aftermath of the ESM fraud, creditors consisting primarily of financial institutions and public bodies (such as municipalities, school boards and taxing authorities) suffered losses exceeding $300 million. One ESM customer located in Ohio, Home State Savings Bank, collapsed due to ESM's fraud. As a result, the Ohio fund insuring deposits of Ohio-chartered savings and loan associations also collapsed, thereby forcing the governor of Ohio to declare the first bank holiday in the United States since the depression.

An essential element of the ESM fraud was the issuance of false financial statements certified by Alexander Grant & Company, a big-eight accounting firm. Such certified financial statements showed ESM to be financially sound, while in reality the ESM Companies were hopelessly insolvent. By keeping the ESM Companies in business long after they should have been in bankruptcy, the officers and directors looted the ESM Companies of more than $60 million through "loans", bonuses and excessive salaries.

On March 5, 1985, the ESM fraud came to abrupt end when the ESM Companies closed their doors and petitioner, Thomas Tew, was appointed receiver for ESM Group, Inc. and ESM Financial Group, Inc., and, later, trustee for the Estate of ESM Government Securities, Inc. ("Receiver/Trustee"). In this, one of the adversary proceedings instituted by the Receiver/Trustee for ESM, the Receiver/Trustee sued Arky, Freed, Stearns, Watson, Greer, Weaver & Harris, P.A. and Eugene E. Stearns for making it possible for the ESM fraud to continue by responding

to ESM's auditors in a way that concealed what Arky, Freed[2] knew about the true financial condition of the ESM Companies. This petition for certiorari stems from the eleventh circuit's affirmance of a summary judgment entered in favor of Arky, Freed on the following claims alleged in the Amended Complaint (App. "A"):

Count II: negligence, *i.e.*, legal malpractice, against Arky, Freed;

Count III:: breach of contract against Arky, Freed; and

Count IV: negligence, *i.e.*, legal malpractice, against Stearns.

In the trial court, petitioner filed his own motion for partial summary judgment against Arky, Freed based on the undisputed fact that—at least as of January 21, 1985—Arky, Freed knew (through its first-named partner, Stephen W. Arky) of the true financial condition of ESM, and failed to take any action in response to that knowledge. To the contrary, Arky, Freed responded to ESM's auditors in a way that: (a) was false and misleading; and (b) caused or contributed to the continuation of the ESM fraud, to the detriment of the ESM Companies and their creditors. The district court denied petitioner's motion. In the same order, the district court invited respondents to file motions for summary judgment on their own behalf on the basis of a lack of any duty of Arky, Freed to ESM (App. "B"), because of what the lower court perceived

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[2] Throughout this Petition, Respondents Arky, Freed, Stearns, Watson, Greer, Weaver & Harris, P.A. and Eugene E. Stearns shall be referred to collectively as "Arky, Freed."

to be the need to protect the confidentiality of attorney-client communications.

Although motions based on lack of a duty would logically have disposed of the entire case against both defendants, respondents filed motions for summary judgment only as to the post-January 21, 1985 events. Those motions were granted by Judgment Orders dated February 26, 1987. (App. "C").

The case was then placed in the awkward position of having been decided but not fully disposed of—as Arky, Freed had not moved for summary judgment on the remainder of the case. Subsequently, Arky, Freed filed a motion for summary judgment on the remaining issues, and the district court entered summary judgment on the balance of petitioner's claim. (App. "D"). Petitioner appealed the Judgment Orders to the eleventh circuit, which on April 29, 1988, affirmed the order *per curiam*, without opinion. (App. "G").

B. Statement of Facts

Prior to 1978, Arky, Freed was retained by the ESM Companies as corporate counsel. The law firm acted as general counsel to ESM until just before its collapse in early 1985. During that period, Arky, Freed received a monthly retainer as well as additional compensation on a case-by-case basis.

As counsel to ESM Government Securities, Inc. ("ESM Government"), Arky, Freed agreed, among other things, to disclose annually to Alexander Grant & Company—ESM's auditors—certain information relevant to the financial condition of ESM Government. Typically,

ESM Government's management sent request letters to Arky, Freed requesting that the law firm furnish to Alexander Grant details of any pending or threatened litigation or claims.[3] The letters also discussed "Unasserted Claims and Assessments," invariably stating management's belief that there were no unasserted claims against ESM Government probable of assertion or which, if asserted, would have a reasonable possibility of an unfavorable outcome. Recognizing that Arky, Freed could disagree with management's assessment and reach a different conclusion regarding such possible unasserted claims, the letters further requested Arky, Freed to confirm to Alexander Grant that ESM Government correctly understood that Arky, Freed would advise and consult with ESM Government "as a matter of professional responsibility" to ESM in the event of any disagreement with management's belief that no claims existed. The letters then reiterated:

> We also inform you that we have represented to our auditors that there are no unasserted possible claims other than those listed above that you have advised are probable of assertion and must be disclosed in accordance with Statement of Financial Accounting

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[3] For convenience, a copy of ESM's January 31, 1985 audit request letter to Arky, Freed is attached as App. "E", and a copy of Arky, Freed's 1985 audit response letter to Alexander Grant is included as App. "F".

> Standards No. 5 in our financial statements at December 31, 1984 and for the year then ended.[4]

When Arky, Freed's 1985 audit response letter was prepared, Stephen Arky knew that management's representation made to the auditors regarding unasserted possible claims was untrue. On January 21, 1985, as the ESM fraud was beginning to unravel, Arky met with the bankruptcy counsel for Ronnie R. Ewton (the "E" in ESM), ESM's chairman of the board and controlling shareholder. At the meeting, Ewton's bankruptcy lawyer told Arky that ESM had suffered massive losses and owed an estimated $180 million to creditors, which it could not repay.

Arky also knew that a substantial portion of that debt was owed to other Arky, Freed clients presently or formerly controlled by his father-in-law, Marvin L. Warner, including Home State Savings Bank of Ohio. After learning of the astounding amount of debt on January 21, 1985, Arky called Marvin Warner to tell him that things were amiss at ESM. Warner immediately called Ewton, with Arky secretly on the line as an undisclosed listener. In that posture, Arky heard Warner and Ewton discuss the massive losses at ESM. In that conversation, Warner demanded of Ewton an explanation for ESM's financial condition, and implored him not to tell anyone else about ESM's losses. Ewton testified:

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[4] The excerpt quoted is from the last request letter, relating to the year ending December 31, 1984, but the same language (with a different year) appears in each request letter from 1979 through 1983. Also, note the implication in the quoted language that, if Arky, Freed advised that an unasserted claim was probable of assertion, that claim would be "listed above" and hence disclosed.

> He [Warner] said to me, Ron, I've just got off the phone with Steve. I can't believe these numbers. How did this happen? I said Marvin, the accumulated losses just got larger than life.
>
> He says, Ron, . . . do you realize this could be the end of Home State? Do you realize this could put the whole fund in jeopardy? I said, yes, I do realize that.
>
> He said, well, what are you going to do? I said, I don't know what I'm going to do.
>
> He said, well, who have you talked to? I said, I haven't talked to anyone.
>
> * * *
>
> He said, well, one, don't talk to anyone about this, nobody.

Ten days later, on January 31, 1985, Arky, Freed received from ESM Government's management a request for Arky, Freed to disclose to Alexander Grant information regarding the financial condition of ESM Government. In the request letter, ESM management falsely represented that it had no knowledge of unasserted claims against ESM Government. Despite its undeniable knowledge that ESM Government had suffered $180 million in losses, and could not repay that sum to its creditors, Arky, Freed did not discuss with ESM the fact that ESM Government faced the probable assertion of claims by such creditors, including claims of Arky, Freed clients Marvin L. Warner and institutions that he controlled. Nor did Arky, Freed advise ESM Government that those possible unasserted claims should be disclosed in ESM Government's audited financial statements. Nor did Arky, Freed request the ESM Companies' permission to disclose those

possible unasserted claims to Alexander Grant. Nor did Arky, Freed call upon the ESM Companies or their officers and directors to rectify the fraud being perpetrated. Nor did Arky, Freed advise ESM management to discontinue their fraudulent business operations. Nor did Arky, Freed resign or even threaten to resign from the engagement. Nor, of course, did Arky, Freed say anything to Alexander Grant concerning the massive losses or possible unasserted claims resulting from ESM Government's financial condition, even though Arky, Freed knew that ESM Government had "[r]epresented to [its] auditors that there [were] no unasserted possible claims . . ." (App. "F").

What Arky, Freed did do, on February 16, 1985, was to sign and deliver a letter to Alexander Grant,[5] falsely stating that it knew of no unasserted claims probable of being asserted, and confirming that if such claims existed it would so advise and consult with ESM Government. The response letter was a prerequisite to the issuance of the ESM financial statement, and thus provided to the auditors a missing item that they needed before the false financial statements could be issued which, in turn, would enable the fraud to continue. Arky knew of the importance of the Arky, Freed response letter, not only because of his

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[5] The Arky, Freed response letter to Alexander Grant was sent on February 16, 1985, well after all of the above knowledge was imparted to Arky, Freed. Within two weeks, Alexander Grant certified the ESM financial statement for the year ending December 31, 1984—the last ESM financial statement issued. Creditors relying on that statement continued to invest or made new investments with ESM, thereby suffering damages, and increasing the claims against the ESM corporate entities.

experience in corporate matters, but also because the managing partner of Alexander Grant told him that the response letter was a "pending item," necessary for the issuance of the ESM financial statement.

Based upon those facts, petitioner moved for summary judgment as to damages suffered after January 21, 1985 events. However, January 21, 1985 was not the first date upon which petitioner contends that Arky, Freed learned of ESM's insolvency and losses or of material unasserted claims against ESM. The record is replete with evidence of Arky, Freed's knowledge of ESM's financial condition, and certain of its fraudulent practices, as early as 1977. There are repeated instances of knowledge of specific facts, which have individual as well as cumulative significance. A summary of such evidence in the record is as follows:

*** In 1977, Ewton told Arky that he and Robert Seneca (the "S" in ESM) would have to use customer margin money in order to fund the acquisition of certain shares of stock by each of them individually, and Arky assured Ewton that he could make use of such customer margin money.

*** In 1977, the Securities and Exchange Commission began investigating ESM for alleged excessive markups, and Ewton expressed to Arky and to Bruce Greer, another Arky, Freed partner, the fear that the SEC investigation might uncover the aforesaid use of customer margin money, which if made known to the broker-dealer community would endanger ESM's lines of credit.

*** In 1977, at a luncheon meeting between Ewton and Greer, who was handling the SEC investigation, Ewton explained to Greer the concept of "customer margin money" using the silverware on the

table, and he told Greer why the revelation of the officers' use of such money would be devastating to ESM. The spoon on the table wound up being the "customer margin money" and was thereafter referred to as "the spoon money." In 1984, upon being asked by Arky to use ESM customer margin money to purchase stock in another financial institution controlled by Marvin L. Warner, Ewton consulted with Greer, who asked Ewton "is this the spoon money again?" When Ewton responded affirmatively, Greer advised Ewton in the presence of Arky not to use it.

*** In Mid-1977, Seneca purchased certain bonds without authorization from an ESM customer, who later refused to accept them. In June of 1978, the bonds were sold by ESM at a loss of some $3,500,000 (more than ESM's net worth). On March 23, 1979, a meeting was held at Arky, Freed's offices at which time Ewton and Seneca told Arky, Freed (represented at the meeting by Arky, Greer, Stearns, and Gerald Cope) of the losses incurred by the Seneca unauthorized trading.

*** In July of 1980, the divorce case of Seneca v. Seneca was tried, with Stearns representing Mr. Seneca, who had previously been forced out of ESM for his unauthorized trading. Mrs. Seneca's expert witness, accountant Victor Karcinell, testified that Mr. Seneca's interest in the ESM companies was of substantial value, although he had received no money for it at the time of his disassociation from ESM. Mrs. Seneca's position was that Ewton was secretly holding money for Seneca until after the divorce case. Stearns cross-examined Karcinell, showed him certain financial documents of the ESM Companies, and got him to admit *that the ESM Companies were broke!* Stearns won the case for Mr. Seneca on that basis.

*** In 1981, ESM was forced to unwind its transactions with Unity Savings & Loan Association of Chicago, and Ewton told Arky that ESM had difficulty in the unwinding and that Burton Bongard, President of Warner-controlled Home State Savings Bank, would be "helping" ESM out of the ensuing crisis.

*** In 1983, Ewton complained to Arky that Arky's father-in-law, Marvin L. Warner, was demanding that ESM return certain margin money belonging to ESM customers and that ESM could not return it.

*** In the fall of 1984, Ewton told Arky that ESM could not unwind its transactions with American Savings and Loan Association of Miami Beach, because ESM "didn't have the money to unwind it."

Notwithstanding such knowledge, Arky, Freed annually rendered to Alexander Grant false or misleading response letters that failed to disclose what Arky, Freed knew: that the ESM Companies were insolvent and/or had suffered extensive losses and were therefore exposed to substantial claims from customers. As a result, false Statements of Financial Condition and Auditors' Reports for ESM Government--which lay at the very heart of the ESM fraud—were issued for the years ending December 31, 1978, 1979, 1980, 1981, 1982, 1983, and 1984.

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REASONS FOR GRANTING THE WRIT

POINT I

THE ISSUES PRESENTED INVOLVE IMPORTANT PUBLIC POLICIES.

The facts of this case illustrate the tension between a lawyer's duties of loyalty to and aggressive representation of a client, and a lawyer's responsibilities to the public dealing with that client. While a lawyer must have loyalty to a client, the extent of that loyalty must be commensurate with the bounds of the law; a lawyer must not assist a client in committing a crime. *See, e.g., Nix v. Whiteside,* 475 U.S. 157 (1986). This case presents fundamental issues regarding how an attorney must act when confronted with the ongoing fraud of his client, or the shareholders, officers or directors of that client.

This case also casts doubts upon the reliability of attorneys' responses to auditors' inquiries of them, which is essential to the accurate functioning of the auditing process. If an attorney's response cannot be relied upon by auditors, in the ultimate analysis an accountant's certification of financial statements also cannot be relied upon. Such audited statements are necessary to enable corporations—especially publicly reporting corporations—to operate and flourish; they are essential to borrowing money and, more importantly, to create trust and honesty in business. In truth, they are a foundation upon which American business rests. Thus, the negative implications of this case are indeed far-reaching.

The result of the decisions of the district court and the eleventh circuit is that a lawyer bears no responsibility for professing to an auditor ignorance of any unasserted claims against a client, while, in fact, having actual knowl-

edge of potential claims arising from an ongoing fraud of the client's officers and directors. A further implication of the decisions is that a lawyer may not bear responsibility for assisting in perpetuating an ongoing fraud. Certiorari should be granted to examine and analyze these unique facts and address the important, complex and fundamental issues that they raise.

POINT II

THE ABA "STATEMENT OF POLICY" DOES NOT GOVERN AN ATTORNEY'S DUTY TO A CLIENT: AN ATTORNEY OWES A DUTY TO ACT WITH REASONABLE CARE.

A. The ABA "Statement of Policy" does not Govern the Lawyer's Duty

The district court decided that this case was governed by a "Statement of Policy Regarding Lawyer's Responses to Auditor's Requests for Information" promulgated by the American Bar Association. The statement was issued after lengthy debate among lawyers and accountants, and was a joint product of the ABA and the American Institute of Certified Public Accountants. Although the statement was promulgated in 1975, remarkably this case is the first and only reported decision to construe, analyze and apply it.

The district court, and the eleventh circuit, improperly held that the statement "governs" the case. It does not. Nothing in the law or in the ABA Statement warrants such a ruling. Membership in the ABA is not, of course, even mandatory for lawyers. Moreover, the ABA Statement itself recognizes in its paragraph 7 that the pronouncements are "for the general guidance of the legal profession" and that a lawyer may, in a particular case,

"elect to supplement or modify the approach hereby set forth." In fact, the ABA Statement does not even purport to define an attorney's duty:

> [N]o lawyer is obliged to enter into an understanding with his client conforming to the ABA Statement of Policy, nor is he obliged to confirm to the auditors that such understanding exists.

ABA Statement of Policy; Second Report of the Committee on Audit Inquiry Responses Regarding Initial Implementation; reprinted in *Auditor's Letter Handbook*, at 44 (1976). In addition, the note to the preamble of the Statement recognizes that the standards contained therein are merely "recommended by the American Bar Association," *not* mandatory.

The district court's Judgment Orders inexplicably and erroneously elevate the ABA Statement to the level of "governing" attorney conduct. Rather, the ABA Statement should be viewed as mere evidence of the requisite standard of care.

An attorney's duty to a client is to exercise a reasonable degree of care, skill and dispatch in carrying out the services for which he is employed. *See, e.g., Gleason v. Title Guarantee Co.*, 317 F.2d 56 (5th Cir. 1963) (attorney's duty is measured by community standards of skill and professional conduct); *Ortiz v. Barrett*, 222 Va. 118, 278 S.E.2d 833 (1981). "Reasonableness" is judged by the standard of professional conduct prevailing in the community in which the attorney practices. *See Gleason*, 317 F.2d at 60. Thus, the "legal duty" owed by Arky, Freed was the duty to use reasonable care, and the Statement of Policy is merely one factor to consider in determining whether that standard of care was met.

More persuasive evidence of the standard of care is contained in the Code of Professional Responsibility. The courts below erred in ignoring the ethical dictates of the Code of Professional Responsibility in finding Arky, Freed's actions to be immune from attack.

In contrast to the "recommended" standards of the ABA Statement, compliance with the Florida Code of Professional Responsibility is mandatory for Florida lawyers like Arky, Freed. The preamble to the 1985 Code of Professional Responsibility provides:

> The disciplinary rules, unlike ethical considerations, are mandatory in character. The disciplinary rules state the *minimum level of conduct* below which no lawyer can fall without being subject to disciplinary action. (Emphasis added).

Noncompliance can result not only in disciplinary action, but also in liability for malpractice. For example, in *Gomez v. Hawkins Concrete Construction Co.*, 623 F.Supp. 194 (N.D. Fla. 1985), the court stated:

> While the Code of Professional Responsibility does not undertake to define liability of lawyers for professional conduct, it constitutes some evidence of standards required of them. *Woodruff v. Tomlin*, 616 F.2d at 924, 936 (6th Cir. 1980).
>
> • • •

623 F.Supp. at 199. *See also Oberon Investments, N.V. v. Angel, Cohen and Rogovin*, 492 So.2d 1113, 1114 n.2 (Fla. 3d DCA 1986) (violation of the Code of Professional Responsibility is evidence of negligence), *quashed on other grounds*, 512 So.2d 1113 (Fla. 1987); *Fishman v. Brooks*, 396 Mass. 643, 487 N.E.2d 1377, 1381 (1986) (violation of

Cannon of Ethics is evidence of attorney's negligence); *Albright v. Burns*, 206 N.J. Super. 625, 503 A.2d 386, 390 (App. Div. 1985) (violations of ethical standards set forth minimum levels of competency, and failure to meet those standards is evidence of malpractice).

Although the district court correctly stated that the Code does not create a private cause of action, the court erred in refusing to consider Arky, Freed's violation of the Code as evidence of negligence. Arky, Freed's violation of DR7-102(B) is undeniable. DR7-102(B), which was applicable to Florida attorneys during the relevant time frame, requires an attorney to call upon his client to rectify a fraud or, if the client is unwilling or unable to do so, to disclose it. DR7-102(B) provides, in pertinent part:

> A lawyer who receives information clearly establishing that:
>
> (1) His client has, in the course of the representation, perpetrated a fraud upon a person or tribunal shall promptly call upon his client to rectify the same, and if his client refuses or is unable to do so, he shall reveal the fraud to the affected person or tribunal.

Arky received information clearly showing that ESM was engaging in a fraud when Ewton's bankruptcy lawyer told him of ESM's losses and when Arky listened in on Ewton's telephone conversation with Warner. By not calling upon ESM or its principals to stop the fraud and by not disclosing it if ESM or its principals refused to do so, Arky, Freed violated DR7-102(B). Arky, Freed went further than failing to attempt to end the fraud,

however. It assisted in enabling perpetuation of the fraud by giving false and misleading information to the auditors. By affirming the district court's summary judgment, the eleventh circuit allowed attorneys to avoid liability for arguably rendering substantial assistance in a massive securities fraud.

B. The ABA Statement is Not a Mantle Protecting a Lawyer's Complicity in a Fraud

Although the ABA Statement may be considered as evidence of the applicable standard of care, contrary to the lower court's rulings, it is not a mantle that protects a lawyer's complicity in a fraud. Rather, the ABA Statement recognizes that a lawyer's professional responsibilities may require disclosure or advising disclosure of a wide range of matters. Paragraph 6 of the ABA Statement states:

> Independent of the scope of his response to the auditor's request for information, the lawyer, depending upon the nature of the matters as to which he is engaged, may have as part of his professional responsibility to his client an obligation to advise the client concerning the need for or advisability of public disclosure of a wide range of events and circumstances. *The lawyer has an obligation not knowingly to participate in any violation by the client of the disclosure requirements of the securities laws. The lawyer also may be required under the Code of Professional Responsibility to resign his engagement if his advice concerning disclosures is disregarded by the client.*

(Emphasis added). As the ABA Statement illustrates, the lawyer's function in undertaking to advise a client about the need to disclose unasserted claims is to enable

the auditors to rely upon management's representations as to the existence or non-existence of unasserted claims. The ABA Statement further states:

> [N]o lawyer is obliged to enter into an understanding with his client conforming to the ABA Statement of Policy, nor is he obliged to confirm to auditors that such an understanding exists; *indeed, if no such undertaking by the lawyer is seriously intended, it would be entirely wrong for the lawyer to do either. In such event, however, the auditor will normally seek some other means of obtaining from the lawyer or others, including other lawyers engaged or employed by the client, corroboration of the information furnished by management concerning unasserted possible claims, in order to satisfy himself concerning compliance by the client with FAS 5.*

ABA Statement of Policy; Second Report of the Committee on Audit Inquiry Responses Regarding Initial Implementation; reprinted in *Auditor's Letter Handbook* at 44. (Emphasis added).

Similarly, the First Report on the ABA Statement, which explains the Statement, specifies that the auditor will rely on the client's assurance that it has disclosed all unasserted possible claims that the lawyer has advised are probable of being asserted. If the client has not disclosed all possible unasserted claims, the auditor may rely on the attorney's taking an appropriate "course of action" to rectify the client's failure to do so. *Auditor's Letter Handbook, supra,* at 36. Likewise, if the client makes representations about advice that it has received from its lawyers that is different from the advice actually given, the ABA Statement says that the lawyer should tell the auditor that such matters "are not in conformity

with agreed procedures." *See Auditor's Letter Handbook, supra,* at 36.

Thus, when an attorney confirms that he will consult with the client about the need to disclose unasserted claims, the auditor will depend upon that promise in relying upon management's representations that no unasserted claims exist. If an attorney does not promise to consult with the client about disclosure, the auditor will have to devise substitute methods to confirm the client's representations that no unasserted claims exist, or issue a qualified opinion on the financial statement. If, as here, an attorney falsely confirms that he will consult with the client, the system breaks down; no alternative methods of verifying management's representations are devised, and a qualified opinion is not issued.

In interpreting the ABA Statement, the district court simply disregarded the above provisions. Here, the courts interpreted the ABA Statement so as to protect client confidentiality even where none existed. Yet, in so doing, the district court failed to consider that Arky, Freed could have maintained client confidentiality by refusing to respond, or by qualifying its response, or by resigning. If Arky, Freed had refused to respond to the audit inquiry or had contradicted the false representations made by ESM's management to the auditors, or had resigned, the result would have been the issuance of a qualified opinion on ESM's financial condition, which might have been unacceptable to ESM's customers, *Auditor's Letter Handbook, supra,* at 45 n.2; ABA Statement ¶4; *Auditor's Letter Handbook,* at page 15, and might ultimately have revealed the fraud as early as 1978—instead of 1985.

The lower courts' rulings thus undermine the reliability of attorney responses to audit inquiries, and thus render attorneys' participation in the auditing process a worthless exercise. The courts' decisions allow an attorney to make untrue representations and promises to an auditor under the guise of protecting client confidentiality—without fear of suffering the consequences of his actions.

POINT III

THE LOWER COURT'S JUDGMENT ORDERS CONFLICT IN PRINCIPLE WITH NIX V. WHITESIDE.

The crux of the district court's ruling is the first sentence contained in the preamble to the ABA Statement. Quoting the first sentence of the preamble, the district court held:

> "The public interest in protecting the confidentiality of lawyer-client communications is fundamental". As concerns this case, "[t]hat is the whole law; the rest is mere commentary." (citation omitted).

The court's focus on attorney-client communications, however, was erroneous. There simply was *no* lawyer-client communication to protect. When Ewton and Warner spoke on the telephone on January 21, 1985, Arky was a *secret listener* to that conversation. No "attorney-client communication" occurred. Nor was there any attorney-client communication involved when Stearns cross-examined an opposing expert witness in open court during a divorce trial in 1980, and persuaded the witness to admit to ESM's insolvency. Accordingly, *there was no confidentiality to protect*—a point totally ignored by the lower court.

Even had Arky, Freed learned of ESM's insolvency through attorney-client communications, public policy requires disclosure, despite attorney-client confidentiality, in the event of an ongoing fraud. This general policy also prohibits lawyers from hiding ongoing frauds with misleading audit response letters. Thus, even had Arky, Freed's knowledge about the ongoing fraud resulted from a confidential communication, it should have acted differently when asked by ESM to respond to its auditors' inquiries.[6]

As has been noted above, the ABA Statement explicitly recognizes:

> The lawyer has an obligation not knowingly to participate in any violation by the client of the disclosure requirements of the securities laws. The lawyer also may be required under the Code of Professional Responsibility to resign his engagement if his advice concerning disclosure is disregarded by the client.

ABA Statement, paragraph 6. Once an attorney learns his client is involved in a continuing fraud, the attorney has a duty to take steps to rectify the fraud or to disclose it. *See, e.g., Florida Code of Professional Responsibility* DR7-102(B) (1985). *McKissick v. United States,* 379 F.2d 754, 761 n.2 (5th Cir. 1967) (lawyer had a duty to report client's perjury to the prosecuting authorities or to the court). The public interest in requiring disclosures is two-fold: first, the failure to act would result in the

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[6] It should be noted that in the letter requesting Arky, Freed to provide information to Alexander Grant, ESM's management waived any attorney-client privilege to the extent necessary to confirm the representations relating to unasserted claims made by ESM's management to Alexander Grant.

lawyer's complicity in an ongoing fraud or a continuing conspiracy by which the fraud remains uncovered;[7] second, disclosure would tend to prevent the continuation of a wrong. *See generally New Jersey Supreme Court Advisory Committee on Professional Ethics,* Op. 591 (1986) (a lawyer has an inherent obligation to prevent a wrong, and may not become involved in an ongoing fraud).

The eleventh circuit's affirmance of the district court's decision in this case conflicts with the principles espoused by this Court in *Nix v. Whiteside,* 475 U.S. 157 (1986). In *Nix,* this Court commented on the tension between attorney-client confidentiality and the duty to disclose under DR 7-102 of the Code of Professional Responsibility:

> Indeed, both the Model Code and the Model Rules do not merely *authorize* disclosure by counsel of client perjury; they *require* such disclosure. (citation omitted).

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[7] In this regard, the SEC has opined that a lawyer's professional responsibilities may require him to persuade his client to avoid or discontinue illegal conduct, and/or to make disclosures sufficient to curtail such conduct. In *In re Carter,* SEC Admin. Proc. File No.: 3-5464, Release No. 17597 (February 28, 1981), the SEC considered the ethical conduct of attorneys for a collapsed public company who had learned that the company had made misleading representations of its financial condition. There the Commission stated that if a lawyer becomes aware of his client's continuing failure to comply with federal securities law disclosure requirements, "his continued participation violates professional standards unless he takes prompt steps to end the client's noncompliance." *Id.* at 45. The Commission further stated: "[A] lawyer is not privileged to unthinkingly permit himself to be co-opted into an ongoing fraud and cast as a dupe or shield for a wrongdoing client." *Id.*

> These standards confirm that the legal profession has accepted that an attorney's ethical duty to advance the interests of his client is limited by an equally solemn duty to comply with the law and standards of professional conduct.

475 U.S. at 168. Although the issue there was different from that presented in the instant case,[8] the public policy considerations are the same. As it was explained by this Court, Arky, Freed's ethical duty to its client is "limited by an equally solemn duty to comply with the law and standards of professional conduct." 475 U.S. at 168.

The same tension between maintaining client confidentiality and disclosing the continuance of a wrong was commented on by the fifth circuit in *McKissick*, 379 F.2d 754. In ruling that disclosure was required, the court stated that a lawyer's claim that he owed his client a paramount duty of non-disclosure [*i.e.*, confidentiality] will not exonerate him from failure to disclose his client's perjury. 379 F.2d at 761, n.2 (quoting *In re King*, 7 Utah 2d 258, 322 P.2d 1095 (1958)). Thus, client confidentiality is *not* to be protected at all costs. The duty to disclose and prevent a continuing wrong is paramount to client confidentiality. The eleventh circuit's affirmance of the district court's ruling erroneously makes client confidentiality superior to all other interests, which clearly is incorrect in light of the principles espoused in *Nix*.

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[8] The issue in *Nix* was whether an accused's Sixth Amendment right to counsel was violated when an attorney advised his client that if the client committed perjury, the attorney would withdraw and would reveal the perjury to the court. 475 U.S. at 157.

Florida Disciplinary Rule 7-102(B), which governed Arky, Freed's conduct in this case, required disclosure even of confidences of a client.[9] *See, e.g.,* Florida Bar Committee on Ethics, Advisory Opinion 82-3 (May 20, 1982), in which the committee stated:

> [U]nder the circumstances described in DR7-102(B) of the Florida Code, an attorney is required to disclose even confidences or secrets of his client. The Supreme Court of Florida, in adopting the Florida Code in its present form, has recognized and mandated this limited exception to the ordinary attorney-client relationship in order to preserve the integrity of the system of administration of justice.

See also Florida Bar Committee on Ethics, Advisory Opinion 75-19 (March 15, 1977) (disclosure of a client fraud upon the court is mandatory under DR7-102(B)). In Opinion 75-19 the committee stated that "the attorney-client privilege is not to be preserved at all costs, or at the cost of the principles represented by DR7-102(B)." *Id.*

Furthermore, in no event does the ABA Statement permit—nor should professional ethics permit—an attorney to give false or misleading information to auditors. The impact of the district court's decision, and the eleventh circuit's affirmance, is to improperly shield an attorney from liability for making untrue and misleading statements regarding his knowledge of the insolvency of

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[9] Florida's DR7-102(B)(1) differs from the ABA Model Code version of DR 7-102(B)(1) in that the ABA version specifically excludes privileged communications from disclosure. The *absence* of such exclusion from the Florida Disciplinary Rule implies that disclosure of a fraud is mandatory, even when confidential communications are involved.

his client, knowing that such statements will be relied on by others. *See* Code of Professional Responsibility DR7-102(A)(5) (a lawyer is prohibited from making statements of fact known by him to be false); *Cf. Gerlach v. Donnelly,* 98 So.2d 493, 498 (Fla. 1957) (an "attorney is under a duty at all times to represent his client and handle the client's affairs with the utmost degree of honesty . . . ").

Thus, the lower court's protection of perceived confidential communications between lawyer and client, in the context of the facts of this case, conflicts with the ethical principles set forth in *Nix*—as well as in the Code of Professional Responsibility and the ABA statement.

POINT IV

SUMMARY JUDGMENT HAS DEPRIVED PETITIONER OF THE OPPORTUNITY TO PROVE ARKY, FREED'S KNOWLEDGE OF ESM'S ONGOING FRAUD.

The district court granted summary judgment, and the eleventh circuit affirmed, despite the clear existence of genuine issues of material fact as to Arky, Freed's pre-January, 1985 knowledge of ESM's insolvency and ongoing fraud.[10] Thus, the lower court's rulings not only misstated the law but also deprived petitioner of the opportunity to have the trier of fact pass judgment on the reasonableness of Arky, Freed's conduct. Consider in that respect the evidence already in the record concerning the conduct of three of Arky, Freed's main partners:

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[10] Petitioner contends that there is no genuine issue of material fact as to Arky, Freed's post-January 21, 1985 knowledge of ESM's insolvency and ongoing fraud.

- Arky's knowledge began in 1977 and culminated on January 21, 1985, when he secretly listened to Ewton and Warner discuss ESM's massive losses.
- Stearns won a case in 1980 by getting the opposing expert witness to admit that the ESM Companies were insolvent.
- Greer knew in 1977 that management of the ESM Companies were using customer funds, which he called "spoon money"; seven years later, he counseled Ewton not to do it any more, even though his partner (Arky) had asked Ewton to do it once again.

By almost any standard, such conduct is at the very least questionable. A trier of fact could well conclude that it is unreasonable, even outrageous. Yet the lower court's ruling precludes any such conclusion. It does so based on a misplaced emphasis on the need to protect "the confidentiality of lawyer-client communications," without even the necessity of proving that such communications took place. The truth is that what Arky heard secretly on January 21, 1985, and what Stearns argued in open court in 1980 do *not* constitute "attorney-client communications" to which any confidentiality could possibly attach. On this point, the lower court's ruling is not only erroneous, it is incomprehensible. At best, there exists an issue of material fact as to whether Arky, Freed acted reasonably in falsely responding to the auditors' requests.

———o———

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

July 28, 1988.

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APPENDIX "A"

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA
FORT LAUDERDALE DIVISION
(CHAPTER 7)

CASE NO. 85-6254-CIV-GONZALEZ

ADVERSARY PROC. NO.
85-6898-Civ-GONZALEZ

IN RE
E.S.M. GOVERNMENT SECURITIES, INC.,

Debtor.
_____/

THOMAS TEW, as Receiver for E.S.M. GROUP, INC. and E.S.M. FINANCIAL GROUP, INC.; and as Trustee for the Estate of E.S.M. GOVERNMENT SECURITIES, INC.,

Plaintiff,
vs. AMENDED COMPLAINT

ARKY, FREED, STEARNS, WATSON, GREER, WEAVER & HARRIS, P.A., EUGENE E. STEARNS, AND BRUCE W. GREER,

Defendants.
_____/

Plaintiff, THOMAS TEW, as Receiver for E.S.M. GROUP INC. and E.S.M. FINANCIAL GROUP, INC., and as Trustee for the Estate of E.S.M. GOVERNMENT SECURITIES, INC., sues Defendant, ARKY, FREED, STEARNS, WATSON, GREER, WEAVER & HARRIS,

P.A., EUGENE E. STEARNS, and BRUCE W. GREER, and alleges:

1. Plaintiff brings this action as equity Receiver of E.S.M. GROUP, INC. ("Group") and E.S.M. FINANCIAL GROUP, INC. ("Financial") and as bankruptcy Trustee for E.S.M. GOVERNMENT SECURITIES, INC. ("GOVERNMENT") (hereinafter collectively referred to as "the E.S.M. Companies"), pursuant to his appointment as Receiver by Order of this Court dated March 4, 1985, in an action entitled *SECURITIES AND EXCHANGE COMMISSION PLAINTIFF vs. E.S.M. GROUP, INC., E.S.M. GOVERNMENT SECURITIES, INC., E.S.M. SECURITIES, INC., E.S.M. FINANCIAL GROUP INC., DEFENDANTS*, Case No. 85-6190-Civ-GONZALEZ, and as Trustee by Order of this Court dated April 17, 1985, in the action entitled *In Re ESM Government Securities, Inc., Debtor*, Case No. 85-6254-Civ-GONZALEZ.

2. Jurisdiction is founded upon 28 U.S.C. § 1334(b), 28 U.S.C. § 157, and upon the doctrine of ancillary and pendent jurisdiction. 28 U.S.C. § 754 vests authority in the Receiver to sue in this District.

3. ARKY, FREED, STEARNS, WATSON, GREER, WEAVER and HARRIS, P.A. (hereinafter "ARKY FREED") was at all relevant times a Professional Association incorporated under the laws of the State of Florida and composed of attorneys practicing law in the State of Florida. EUGENE E. STEARNS ("STEARNS") and BRUCE W. GREER ("GREER") were at all relevant times shareholders of ARKY FREED.

4. Government was a wholly owned subsidiary of Group, and Financial was an affiliate of Group, in that

Financial was 100% owned by Ronnie Ewton, who in turn owned 62% of the stock of and controlled Group. The interrelated corporate entities comprising the E.S.M. Companies included the following:

(a) Group, a Florida corporation, a parent and holding company for several subsidiaries which paid certain operating expenses of its subsidiaries.

(b) Government, a Florida corporation, a securities broker-dealer trading in government securities and registered with the Florida Division of Securities and other state securities commissions. It is a totally-owned subsidiary of Group.

(c) E.S.M. Securities, Inc. ("Securities"), a Florida corporation, a securities broker-dealer registered with the Securities and Exchange Commission and a member of the National Association of Securities Dealers. It is a wholly-owned subsidiary of Group.

(d) E.S.M. Aviation, Inc. ("Aviation"), a Florida corporation, operated and/or owned executive aircraft used by officers and directors of one or more of the E.S.M. Companies. Aviation is a wholly-owned subsidiary of Group.

(e) Financial, a Florida corporation, acted as an operator and lessor of real estate as well as an investment company. Its capital stock was owned by Ronnie R. Ewton.

COUNT I

FIRST CLAIM FOR RELIEF

(11 U.S.C. §§ 547(b), 550)

5. The Trustee realleges paragraphs 1 through 4, above.

6. On March 26, 1985, an involuntary petition for relief under Chapter 7 of the Bankruptcy Code was filed

by certain creditors of Government, and on March 27, 1985, an Order for Relief was entered against Government.

7. On January 23 and 24, 1985, Government was indebted to ARKY FREED as a result of services rendered to it by ARKY FREED during the months of April through October, 1984.

8. On January 23, 1985, Government transferred funds to Group to cover Government's antecedent indebtedness to ARKY FREED. Group in turn transferred to ARKY FREED on January 24, 1985, property totalling $38,500.00.

9. The foregoing transfer to ARKY FREED through Group constituted a transfer of Government's property within ninety days prior to the filing of the involuntary petition.

10. The transfer to ARKY FREED was made at a time when Government was insolvent.

11. The transfer to ARKY FREED enabled it to receive more than if (i) the transfer had not been made and (ii) ARKY FREED received payment on Government's indebtedness to it to the extent provided by U.S.C. Title 11.

12. The transfer to ARKY FREED constitutes a preferential transfer that may be avoided by the Trustee pursuant to 11 U.S.C. § 547(b) and recovered for the benefit of Government's estate pursuant to 11 U.S.C. § 550.

WHEREFORE, the Trustee demands judgment avoiding the transfer to ARKY FREED pursuant to 11 U.S.C. § 547(b), awarding to Government's estate the value of

the transfer pursuant to 11 U.S.C. § 550, and granting such other and further relief as is just, including interest and the costs of this action.

COUNT II

NEGLIGENCE: ARKY FREED

13. Plaintiff realleges paragraphs 1 through 4, above.

14. Prior to 1978, at a date not specifically known to Plaintiff at this time, ARKY FREED was retained by the E.S.M. Companies as corporate counsel. Such engagement lasted until early 1985. As corporate counsel, ARKY FREED agreed, among other things, to disclose annually to the accounting and auditing firm of Alexander Grant & Company information material to the financial condition of the E.S.M. Companies, and assumed the professional responsibility to the E.S.M. Companies to follow all requirements and standards required by the American Bar Association Statement: Lawyer's Responses to Auditors' Requests for Information (December 1975) ("ABA Statement"), the applicable requirements of the statement of Financial Accounting Standards No. 5 ("FAS No. 5"), and the Florida Code of Professional Responsibility, Disciplinary Rule 7-102 ("D.R. 7-102").

15. As early as 1978, officers, directors, and/or employees of ARKY FREED knew that the E.S.M. Companies were insolvent and/or were suffering extensive losses. Notwithstanding such knowledge, ARKY FREED annually rendered to said auditors false or misleading response letters that failed to disclose that the E.S.M. Companies were insolvent and/or had suffered extensive losses, thereby enabling said auditors to render false and

misleading Statements of Financial Condition and Auditors' Reports for Government for the years ending December 31, 1978, 1979, 1980, 1981, 1982, 1983, and 1984.

16. In connection with its representation of the E.S.M. Companies, ARKY FREED owed a duty to comply with the E.S.M. Companies' requests and the aforementioned standards and requirements in disclosing information material to the financial condition of the E.S.M. Companies.

17. ARKY FREED failed to exercise reasonable care by virtue of the following acts and omission, among others:

(a) Failing to adhere to its professional responsibilities as set forth in the aforementioned requirements and standards by failing to disclose information material to the financial condition of the E.S.M. Companies and known to ARKY FREED;

(b) Failing to use reasonable care in preparing attorney response letters to auditors, to ensure that such response letters accurately reflected matters known by ARKY FREED materially to affect the financial condition of the E.S.M. Companies; and

(c) Stating facts that ARKY FREED knew to be inaccurate, false, and/or misleading with respect to the financial condition of the E.S.M. Companies.

18. ARKY FREED's conduct in representing the E.S.M. Companies fell below the legal community's standards of professional conduct in South Florida for the subject representation.

19. The acts and omissions complained of were committed by officers, agents, or employees of ARKY FREED while engaged on behalf of ARKY FREED in rendering professional service to the E.S.M. Companies.

20. As a proximate result of ARKY FREED's aforementioned conduct, the E.S.M. Companies suffered extensive damage, the total amount of which has not been quantified or segregated among the E.S.M. Companies, as follows:

(a) The business life of the E.S.M. Companies was artifically prolonged beyond the point of insolvency, which enabled the E.S.M. Companies to continue to sustain additional trading losses, incur greater debt than they otherwise would have, make unprofitable investments, and suffered increased exposure to creditor liability, further aggravating their insolvency and the dissipation and diminution of their assets; and

(b) The prolonged existence of the E.S.M. Companies caused additional funds to be pumped into said companies and thereby enabled the officers and directors to continue to withdraw money and loot the assets of the E.S.M. Companies in the form of salaries, commissions, bonuses, and loans for their own benefit and to the detriment of the E.S.M. Companies.

21. But for the foregoing acts or omissions by ARKY FREED, the E.S.M. Companies would not have been able to prolong their business life and would not have suffered the additional losses set forth above.

22. The damages suffered by the E.S.M. Companies were a reasonably foreseeable consequence of the defendants' conduct. ARKY FREED knew or should have

known that the conduct complained of would cause or contribute to the damages incurred as a result of the continued existence of the E.S.M. Companies despite their insolvency.

WHEREFORE, Plaintiff demands judgment against ARKY FREED for the aforesaid damages suffered by the E.S.M. Companies, as such damages may ultimately be quantified and segregated, together with costs.

COUNT III
BREACH OF CONTRACT

23. Plaintiff realleges paragraphs 1 through 4 and 14 through 22, above.

24. Prior to 1978, at a date not specifically known to Plaintiff at this time, ARKY FREED and the E.S.M. Companies entered into an oral and/or implied contract pursuant to which ARKY FREED agreed to act as corporate counsel to the E.S.M. Companies, and the E.S.M. Companies agreed to pay ARKY FREED for its legal services.

25. The aforesaid contract required ARKY FREED, among other things, annually to disclose to the accounting and auditing firm of Alexander Grant & Co. information material to the financial condition of the E.S.M. Companies.

26. ARKY FREED breached said contract by the acts and omissions alleged in Paragraphs 17(a), 17(b), and 17(c), above. The acts and omissions complained of were committed by officers, agents, or employees of ARKY FREED, while engaged on behalf of ARKY FREED in rendering professional services to the E.S.M. Companies.

27. The aforesaid breach of contract has caused damage to the E.S.M. Companies, as alleged in Paragraphs 20(a) and 20(b), above.

28. All conditions precedent required of the E.S.M. Companies have been met.

WHEREFORE, Plaintiff demands judgment against ARKY FREED for the aforesaid damages suffered by the E.S.M. Companies, as such damages may ultimately be quantified and segregated, together with interests and costs.

COUNT IV
NEGLIGENCE: STEARNS

29. Plaintiff realleges paragraphs 1 through 4 and 14 through 22, above.

30. The acts or omissions complained of by Plaintiff and alleged in paragraphs 15 through 18, above, were committed, among others, by STEARNS or by persons under his direct supervision or control, while rendering professional services on behalf of ARKY FREED to the E.S.M. Companies.

31. Accordingly, Defendant STEARNS is personally liable and accountable for such conduct, pursuant to the provisions of Fla. Stat. § 621.07.

WHEREFORE, Plaintiff demands judgment against Defendant STEARNS for the aforesaid damages suffered by the E.S.M. Companies, as such damages may ultimately be quantified and segregated, together with costs.

COUNT V
NEGLIGENCE: GREER

32. Plaintiff realleges paragraphs 1 through 4 and 14 through 22, above.

33. The acts or omissions complained of by Plaintiff and alleged in paragraphs 15 through 18, above, were committed, among others, by GREER or by persons under his direct supervision or control, while rendering professional services on behalf of ARKY FREED to the E.S.M. Companies.

34. Accordingly, Defendant Greer is personally liable and accountable of such conduct, pursuant to the provisions of Fla. Stat. § 621.07.

WHEREFORE, Plaintiff demands judgment against Defendant GREER for the aforesaid damages suffered by the E.S.M. Companies, as such damages may ultimately be quantified and segregated, together with costs.

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/s/ By: Jose Garcia-Pedrosa

APPENDIX "B"

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA

CASE NO. 85-6254-CIV-GONZALEZ

IN RE:

E.S.M. GOVERNMENT SECURITIES, INC.,

Debtor.

_____/

THOMAS TEW, as Receiver for E.S.M. GROUP, INC. and E.S.M. FINANCIAL GROUP, INC. and as Trustee for the Estate of E.S.M. GOVERNMENT SECURITIES, INC.,

Plaintiff,

vs.

ARKY, FREED, STEARNS WATSON, GREER, WEAVER & HARRIS, P.A., and EUGENE STEARNS,

Defendants.

_____/

Adv. Pro. No. 85-6898-CIV-GONZALEZ

O R D E R

THIS CAUSE has come before the court upon the parties' Motions for Partial Summary Judgment. The court having considered the motions, the supporting memoranda of law and accompanying exhibits, and the argument of counsel, and being duly advised therein, it is hereby

ORDERED AND ADJUDGED:

1. As to Plaintiff's Amended Motion for Partial Summary Judgment, the court reserves ruling on Count I, as this count was not argued before the court. Count II and Count III of the Amended Motion for Partial Summary Judgment are DENIED as the court does not find that the plaintiff is entitled to summary judgment as a matter of law.

2. The motion for Partial Summary Judgment filed by defendant Arky, Freed, Stearns, Greer, Weaver & Harris, P.A. be and the same is DENIED. Defendants are invited to file their Motion for Summary Judgment within twenty (20) days of this Order. *See* 10A C. Wright, A. Miller, & M. Kane, Federal Practice and Procedure: Civil 2d § 2720 (1983).

DONE AND ORDERED at Chambers, Fort Lauderdale, Florida, this 3rd day of November, 1986.

/s/ Jose A. Gonzales, Jr.
JOSE A. GONZALES, JR.
UNITED STATES DISTRICT JUDGE

copies furnished counsel

APPENDIX "C"

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA

CASE NO. 85-6898-CIV-GONZALEZ

THOMAS TEW, as receiver for E.S.M. GROUP, INC. and E.S.M. FINANCIAL GROUP, INC. and as Trustee for the Estate of E.S.M. GOVERNMENT SECURITIES, INC.,

Plaintiff,

vs.

ARKY, FREED, STEARNS, WATSON GREER, WEAVER & HARRIS, P.A. and EUGENE E. STEARNS,

Defendants.
_____/

JUDGMENT ORDER

(Filed February 26, 1987)

Defendant Arky, Freed, Stearns, Watson, Greer, Weaver & Harris, P.A. ("Arky Freed") has moved pursuant to Fed. R. Cov. P. 56 for partial summary judgment on Counts II and III of the Amended Complaint as to any liability resulting from the events of January 21, 1985, a date upon which plaintiff claims that Stephen Arky, a former member of Arky Freed, learned of the insolvency of ESM*.

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* Unless otherwise indicated herein, the term "ESM" refers to E.S.M. Government Securities, Inc., E.S.M. Group, Inc. and E.S.M. Financial Group, Inc.

The court has considered the briefs, affidavits, deposition testimony, and exhibits submitted by the parties, as well as the arguments of counsel. The court finds that there is no genuine issue of material fact and that Arky Freed's motion for partial summary judgment must be granted as a matter of law.

Arky Freed owed no legal duty to disclose to ESM's auditors, Alexander Grant & Co. ("Grant"), Stephen Arky's alleged knowledge of ESM's financial condition purportedly obtained in a meeting attended by Mr. Arky on January 21, 1985, approximately six weeks prior to ESM's collapse.

An attorney's responsibility with respect to responses to auditor's inquiries is governed by the American Bar Association "Statement of Policy Regarding Lawyer's Responses to Auditor's Request For Information" ("ABA Statement"). The preamble of the ABA Statement reads: "The public interest in protecting the confidentiality of lawyer-client communications is fundamental." As concerns this case, "[t]hat is the whole law; the rest is mere commentary." Hillel, *Pirke Avot (Ethics of the Fathers), quoted in* 14 Encyclopedia Americana 197 (1984).

The ABA Statement provides that an attorney is authorized to disclose information to his client's auditors only where the client has both "specifically identified" "in the [audit] inquiry letter or supplement thereto" a particular unasserted claim or assessment, and has "specifically requested" comment by the attorney on that unasserted claim or assessment. ABA Statement, Paragraph 2. The requirement that the client both specifically identify and specifically request comment on the unasserted

claim or assessment in the audit inquiry letter is predicated on the ABA Statement's fundamental concern with preserving the confidentiality of attorney-client communications. Under the ABA Statement, an attorney has no duty "to investigate . . . legal problems of the client, even when on notice of some facts which might conceivably constitute a legal problem . . . ." nor should he ". . . . include information concerning the client which the lawyer receives in another role." ABA Statement, Commentary to Paragraph 2.

There is no genuine issue of material fact that ESM ever identified its financial problems in its auditor's inquiry letters to Arky Freed, or requested Arky Freed to comment thereon. In fact, the ABA Statements limitations on an attorney's duties were expressly contained in both ESM's audit inquiry letters to Arky Freed, and Arky Freed's audit responses. Furthermore, Mr. Arky was not consulted or retained by ESM at the January 21, 1985 meeting, but rather was consulted concerning Mr. Ron Ewton's personal affairs. Failure to disclose under these circumstances does not constitute either negligence or breach of contract.

The plaintiff also relies upon the Disciplinary Rule 7-102(B) of the Florida Code of Professional Responsibility to support his negligence theory against Arky Freed. As the Florida Supreme Court has plainly stated: "Violation of a [disciplinary] rule should not give rise to a cause of action nor should it create any presumption that a legal duty has been breached. . . . [The rules] are not designed to be a basis for liability. . . . Accordingly, nothing in the rules should be deemed to augment any sub-

stantive duty of lawyers or the extra-disciplinary consequences or violating such duty."

The plaintiff has failed to cite any case holding that the Disciplinary Rules create a private cause of action, and this Court is aware of none. Numerous cases hold that the Disciplinary Rules do not create a private cause of action. *See, e.g., Bickel v. Mackie,* 447 F.Supp. 1376 (N.D. Ia. 1979), *aff'd mem.,* 590 F.2d 341 (8th Cir. 1978); *Merrit-Chapman & Scott Corp. v. Elgin, Coal, Inc.,* 358 F. Supp. 17, 22 (E.D. Tenn. 1972), *aff'd,* 477 F.2d 598 (6th Cir. 1973); *Nobel v. Sears, Roebuck & Co.,* 33 Cal. App. 3d 654, 109 Cal. Rptr. 269, 271-72 (1973). Thus, DR 7-102(B) imposed no legal duty upon Arky Freed.

Accordingly, the court hereby enters judgment in favor of Arky Freed dismissing with prejudice plaintiff's claims in Counts II and III of the Amended Complaint which arise out of the events of January 21, 1985.

DONE AND ORDERED in Chambers, at Fort Lauderdale, Florida, this 26th day of February, 1987.

/s/ Jose A. Gonzalez, Jr.
Jose A. Gonzalez, Jr.
UNITED STATES
DISTRICT JUDGE

Copies furnished counsel

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA

CASE NO. 85-6898-CIV-GONZALEZ

THOMAS TEW, as Receiver for E.S.M. GROUP, INC. and E.S.M. FINANCIAL GROUP, INC. and as Trustee for the Estate of E.S.M. GOVERNMENT SECURITIES, INC.,

Plaintiff,

vs.

ARKY, FREED, STEARNS, WATSON, GREER, WEAVER & HARRIS, P.A., and EUGENE E. STEARNS,

Defendants.
_____/

JUDGMENT ORDER

(Filed February 26, 1987)

Defendant Eugene E. Stearns has moved pursuant to Fed. R. Civ. P. 56 for summary judgment in his favor on Count IV of the Amended Complaint, the only count brought against Mr. Stearns personally. The court has considered the briefs, affidavits, deposition testimony, and exhibits submitted by the parties, as well as the arguments of counsel. The court finds that there is no genuine issue of material fact and that Mr. Stearns' motion for complete summary judgment must be granted as a matter of law. Mr. Stearns owed no legal duty to advise ESM's

auditors, Alexander Grant & Co. ("Grant"), of his alleged knowledge of ESM's* financial problems.

An attorney's responsibility with respect to responses to auditor's inquiries is governed by the American Bar Association "Statement of Policy Regarding Lawyer's Responses to Auditor's Request For Information" (ABA Statement"). The preamble of the ABA Statement reads: "The public interest in protecting the confidentiality of lawyer-client communications is fundamental." The remainder o fthe ABA Statement is designed with this fundamental interest in mind. In this case, "(t)hat [confidentiality] is the whole law; the rest is mere commentary." Hillel, *Pirke Avot* (*Ethics of the Fathers*) *quoted in* 14 Encyclopedia Americana 197 (1984).

The ABA Statement provides that a lawyer's response to an auditor's inquiry "is properly limited to matters which had been given substantive attention by the lawyer in the form of legal consultation, and, where appropriate legal representation . . ." ABA Statement, Paragraph 2. Indeed, the Commentary to Paragraph 2, which is an integral part of the ABA Statement, states that a lawyer's response "should not include information concerning the client which the lawyer receives in another role." The ABA Statement also provides that an attorney is authorized to disclose information to his client's auditors only where the client has both "specifically identified" "in the [audit] inquiry letter or supplement thereto" a particular unasserted claim or assessment, and has "specifically re-

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* Unless otherwise indicated herein, the term "ESM" refers to E.S.M. Government Securities, Inc., E.S.M. Group, Inc. and E.S.M. Financial Group, Inc

quested'' comment by the attorney on that unasserted claim or assessment. ABA Statement, Paragraph 2.

The requirement that the client both specifically identify and specifically request comment on the unasserted claim or assessment in the audit inquiry letter is predicated on the ABA Statement's fundamental concern with preserving the confidentiality of attorney-client communications. Under the ABA Statement, an attorney has no duty ''to investigate . . . legal problems of the client, even when on notice of some facts which might conceivably constitute a legal problem. . . . '' ABA Statement, Commentary to Paragraph 2.

Here, there is no evidence that ESM ever retained Mr. Stearns to devote substantive attention to its financial problems. In fact, the record in this case establishes without question that Mr. Stearns did virtually no work at all for ESM. Accordingly, even under the ABA Statement, it is patently clear as a matter of law that Mr. Stearns owed no legal duty to disclose. Having rendered almost no services to ESM—and never having been retained by ESM regarding its financial problems—Mr. Stearns simply cannot be sued for legal malpractice for not disclosing his alleged knowledge of ESM's financial problems. In addition, there is no evidence that ESM ever identified its financial problems in its auditor's inquiry letters or requested comment thereon.

The plaintiff also relies upon the Disciplinary Rule 7-102(B) of the Florida Code of Professional Responsibility to support his negligence theory against Mr. Stearns. Plaintiff's reliance on DR 7-102(B) is misplaced. The Florida Supreme Court has plainly stated: ''Violation of

a [disciplinary] rule should not give rise to a cause of action nor should it create any presumption that a legal duty has been breached. . . . [The rules] are not designed to be a basis for liability. . . . Accordingly, nothing in the rules should be deemed to augment any substantive duty of lawyers or the extra-disciplinary consequences for violating such duty." Preamble to Chapter 4: Rules of Professional Conduct.

The plaintiff has failed to cite any case holding that the Disciplinary Rules create a private cause of action, and this Court is aware of none. Numerous cases hold that the Disciplinary Rules do not create a private cause of action. *See e.q., Bickel v. Mackie,* 447 F. Supp. 1376, 1383 (N.D. Ia. 1978), *aff'd mem.,* 590 F.2d 341 (8th Cir. 1978); *Merrit-Chapman & Scott Corp. v. Elgin Coal, Inc.,* 358 F. Supp. 17, 22 (E.D. Tenn. 1972), *aff'd,* 477 F.2d 598 (6th Cir. 1973); *Nobel v. Sears, Roebuck & Co.,* 33 Cal App. 3d 654, 109 Cal. Rptr. 269, 271-72 (1973). Thus, it is clear as a matter of law that DR 7-102(B) imposed no legal duty upon Mr. Stearns for the breach of which he may be held liable.

The court has considered the plaintiff's remaining factual and legal arguments and finds them insufficient to defeat Mr. Stearns' motion for summary judgment. The court hereby enters final judgment dismissing with prejudice Count IV of the Amended Complaint and this action against Eugene E. Stearns, and awards Mr. Stearns his costs of suit herein. The court expressly finds pursuant to Fed. R. Div. (sic) P. 54(b) that there is no just reason for delay and expressly directs entry of this final judgment of dismissal with prejudice of the entire claim against Mr. Stearns.

DONE AND ORDERED in Chambers, at Fort Lauderdale, Florida, this 26th day of February, 1987.

/s/ Jose A. Gonzalez, Jr.
Jose A. Gonzalez, Jr.
UNITED STATES DISTRICT JUDGE

Copies furnished counsel

APPENDIX "D"

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA
FORT LAUDERDALE DIVISION

CASE NO.: 85-6898-CIV-GONZALEZ

THOMAS TEW, as Receiver for
E.S.M. GROUP, INC., and E.S.M.
FINANCIAL GROUP, INC.; and as
Trustee for the Estate of E.S.M.
GOVERNMENT SECURITIES, INC.,

Plaintiffs,

vs.

ARKY, FREED, STEARNS, WATSON,
GREER, WEAVER & HARRIS, P.A.,

Defendant.
_____/

JUDGMENT ORDERED

(Filed April 27, 1987)

Defendant Arky, Freed, Stearns, Watson, Greer, Weaver & Harris, P.A., ("Arky Freed") has moved pursuant to Fed. R. Civ. P. 56 for complete summary judgment on Counts II and III of the Amended Complaint. This Court on February 26, 1987, entered partial summary judgment on those counts in favor of Arky Freed, and complete summary judgment in favor of an Arky Freed attorney who was sued personally. Arky Freed asserts that the Court's prior decisions control the instant motion. Plaintiff agrees, but argues that the Court's prior decisions were flawed. This Court has considered the parties' arguments, and remains convinced that its prior decisions are correct and govern the instant motion. Ac-

cordingly, the Court finds that there is no genuine issue of material fact and, for the reasons stated in this Court's prior orders of February 26, 1987, the Court hereby enters complete summary judgment in favor of Arky Freed dismissing with prejudice Counts II and III of the Amended Complaint, and awards Arky Freed its costs of suit herein. The Court expressly finds pursuant to Fed. R. Civ. P. 54(b) that there is no reason for delay and expressly directs both the entry of this final judgment of dismissal with prejudice of Counts II and III against Arky Freed, and the entry of a final judgment of dismissal with prejudice under this Court's February 26, 1987 order granting Arky Freed partial summary judgment.

DONE AND ORDERED in Chambers, at Fort Lauderdale, Florida, this 28th day of April, 1987.

/s/ Jose A. Gonzalez, Jr.
Jose A. Gonzalez, Jr.
UNITED STATES DISTRICT JUDGE

Copies furnished counsel

APPENDIX "E"

E.S.M. GOVERNMENT SECURITIES, INC.

January 31, 1985

Arky, Freed, Stearns, Watson, Greer,
Weaver & Harris, P. A.
One Biscayne Tower
Two South Biscayne Blvd.
Miami, Florida 33131

Gentlemen:

For purposes of verification in connection with an audit, will you please furnish our auditors, Alexander Grant & Company, with information relative to the matters set forth below, which the companies regard as material, with respect to which you have been engaged and to which you have devoted substantive attention on behalf of the companies in the form of legal consultation or representation, including in your response such matters that existed at December 31, 1984 and during the period from that date to the date of your response.

Pending or Threatened Litigation

Please furnish details of any litigation or law suits in which the companies are involved directly or indirectly, and of any claims asserted against these companies even though legal proceedings have not started, including (1) the nature of the pending or threatened litigation, (2) the progress of the matter to date, (3) the response which is being made or which will be made to the matter, and (4) an evaluation of the likelihood of an unfavorable outcome and an estimate, if one can be made, of the amount or range of potential loss.

Unasserted Claims and Assessments

Management of these companies believe that there are no unasserted claims which are probable of assertion or which, if asserted, would have at least a reasonable possibility of an unfavorable outcome.

It is our understanding that in the course of providing legal services for us regarding a matter recognized to involve an unasserted claim, you may form a professional conclusion as to the need to disclose such a possible claim or assessment. It is also our understanding that whenever you have formed such a conclusion, you will, as a matter of professional responsibility to us, advise us and consult with us concerning the question of such disclosure and the applicable requirements of Statement of Financial Accounting Standards No. 5. Please specifically confirm to our auditors that our understanding is correct.

We also inform you that we have represented to our auditors that there are no unasserted possible claims other than those listed above that you have advised are probable of assertion and must be disclosed in accordance with Statement of Financial Accounting Standards No. 5 in our financial statements at December 31, 1984 and for the year then ended.

Please specifically identify the nature of and reasons for any limitation on your response.

Other Matters

Please furnish our auditors:

1. Information about any financing statements filed under the Uniform Commercial Code or any other assignment of the company's assets.

2. Amounts due you, if any, for services, whether billed or unbilled.

A business reply envelope is enclosed for your convenience in replying directly to Alexander Grant & Company, Certified Public Accountants, 1900 One Financial Plaza, Fort Lauderdale, Florida 33394.

Very truly yours,

E.S.M. GOVERNMENT SECURITIES, INC.

/s/ George G. Mead
Vice President

/kmc

APPENDIX "F"

January 31, 1985

Alexander Grant & Company
Certified Public Accountants
1900 One Financial Plaza
Fort Lauderdale, Florida 33394

RE: E.S.M. Securities, Inc., E.S.M. Government Securities, Inc. and E.S.M. Group, Inc., (the "Companies")

To Whom It May Concern:

We have been requested by George G. Mead, Vice President of E.S.M. Government Securities, Inc., to furnish you with certain information in connection with your audit of the Companies.

This letter and the information contained herein is being submitted to you in connection with the preparation of financial statements as of December 31, 1984. You are not authorized to use this letter for any other purpose or to provide copies of this letter to any other person or governmental agency without the express written consent of this firm.

While this firm represents the Companies on a regular basis, our engagement has been limited to specific matters as to which we were consulted by the Companies. Subject to the foregoing and to the last paragraph of this letter, we advise you that for the period ended December 31, 1984, and as of the date hereof, we have not been engaged to give substantive attention to or represent the Companies in connection with any material loss contingencies coming within the scope of Paragraph 5 of the Statement of Policy referred to in the last paragraph of this letter, except as follows:

United States of America v. One 1981 Rockwell International Commander 690C/840, Serial Number 11627, Civil Number 82-A2—United States District Court—North Dakota.

E.S.M. Aviation, Inc. ("E.S.M. Aviation") is a wholly-owned subsidiary of E.S.M. Group. E.S.M. Aviation is the owner of a 1981 Rockwell International Commander 690C/840, Serial Number 11627. On December 20, 1981, the Rockwell aircraft was seized by agents of the federal government pursuant to 21 U.S.C. § 881 for facilitating the transportation of controlled substances. On the flight in question, E.S.M. Aviation had leased the aircraft to Cav Air, Inc., a licensed air carrier. Cav Air, in turn, had chartered the plane and provided a pilot to three individuals who were arrested in Fargo, North Dakota, indicted and convicted for federal narcotics violations. No employee of E.S.M. Aviation or Cav Air has been implicated in any wrongdoing.

On May 10, 1982, the United States of America commenced judicial forfeiture proceedings against the subject aircraft, seeking to extinguish E.S.M. Aviation's ownership interest in the aircraft. On June 9, 1982, E.S.M. Aviation answered the complaint for forfeiture and counterclaimed for damages against the United States. On August 3, 1983, E.S.M. Aviation moved for summary judgment, arguing that the airplane is not subject to forfeiture because it was being used as a common carrier and neither the captain nor the crew was acting in concert or privity with the persons transporting controlled substances. In the alternative, E.S.M. Aviation argued that the airplane is not subject to forfeiture because the owners did every-

thing reasonably possible to avoid the airplane being used in an unlawful fashion. On September 6, 1983, the Court agreed in part with E.S.M. Aviation's position. The Court ruled that the flight in question was conducted as a common carrier and the burden therefore shifted to the government to demonstrate that the owner or operator was privy to or consented to the illegal transportation of contraband. A trial on this sole issue commenced February 21, 1984. On February 24, a jury returned a verdict in favor of E.S.M. Aviation and on February 27 judgment was entered directing that the aircraft be immediately returned to E.S.M. Aviation.

On March 8, 1984, the government moved for reconsideration of the trial court's September 6, 1983 ruling that the flight in question was conducted as a common carrier. Over E.S.M.'s objection, on June 29, 1984, the trial court reversed its earlier ruling, entered a directed verdict and final judgment in favor of the government and ordered forfeiture of the aircraft. On July 9, 1984, E.S.M. appealed the trial court's ruling. On December 12, 1984, the appellate court heard argument and, on February 8, 1985, the appellate court reversed the trial court's forfeiture of the aircraft. The appellate court reinstated the jury verdict and directed that the aircraft be returned to E.S.M. Aviation.

As of December 31, 1984, the Companies had no outstanding balance for services rendered by this firm.

This response is limited by and in accordance with the ABA Statement of Policy Regarding Lawyers' Responses to Auditors' Request for Information (December, 1975). Without limiting the generality of the foregoing, the limi-

tations set forth in such Statement on the scope and use of this response (Paragraphs 2 and 7) and specifically incorporated herein by reference and any description herein of any "loss contingencies" is qualified in its entirety by Paragraph 5 of the Statement and the accompanying Commentary (which is an integral part of the Statement). Consistent with the last sentence of Paragraph 6 of the ABA Statement of Policy and pursuant to the Companies' request, this will confirm as correct that whenever in the course of performing legal services for the Companies with respect to a matter recognized to involve an unasserted possible claim or assessment that may call for financial statement disclosure, we have formed a professional conclusion that the Companies must disclose or consider disclosure concerning such possible claim or assessment, we, as a matter of professional responsibility to the Companies, will so advise the Companies and will consult with the Companies concerning the question of such disclosure and the applicable requirements of Statement of Financial Accounting Standards No. 5.

Very truly yours,

ARKY, FREED, STEARNS, WATSON, GREER, WEAVER & HARRIS, P.A.

/s/ Arky Freed Stearns Watson Greer Weaver & Harris, P.A.

MMW: tee
cc: E.S.M. Securities, Inc.
E.S.M. Government Securities, Inc.
E.S.M. Group, Inc.
c/o E.S.M. Government Securities, Inc.

APPENDIX "G"

FOR THE ELEVENTH CIRCUIT

No. 87-5248

D.C. Docket No. 85-6898

IN RE: ESM GOVERNMENT SECURITIES, INC.,

Debtor.

THOMAS TEW, As received for ESM GROUP, INC., and ESM FINANCIAL GROUP, INC., and Trustee for the Estate of ESM GOVERNMENT SECURITIES, INC.,

Plaintiff-Appellant,

versus

ARKY, FREED, STEARNES (sic), WATSON, GREER, WEAVER & HARRIS,

Defendant-Appellee.

No. 87-5405

D.C. Docket No. 85-6898

In Re: E.S.M. GOVERNMENT SECURITIES, INC.,

Debtor.

THOMAS TEW, as Receiver for E.S.M. Group, INC. and E.S.M. FINANCIAL GROUP, INC., and TRUSTEE for the Estate of E.S.M. GOVERNMENT SECURITIES, INC.,

Plaintiff-Appellant,

versus

ARKY, FREED, STEARNS, WATSON, GREER, WEAVER & HARRIS, P.A.,

Defendants-Appellees.

Appeals from the United States District Court for the Southern District of Florida

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(April 29, 1988)

Before TJOFLAT and HILL, Circuit Judges, and HALL*, District Judge.

PER CURIAM: AFFIRMED. See 11th Cir. R. 36-1.

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* Honorable Robert H. Hall, U.S. District Judge for the Northern District of Georgia, sitting by designation.